the economics of tourism destinations

destination management... ...destination marketing...

...tourism geography...

but, where is the ECONOMICS of DESTINATIONS?

the destination is an original and interesting object of study from the economist's perspective

i. the **tourism product is a bundle of goods** (a set of elementary items demanded, in a relationship of complementarity, by the tourist);

ii. not the firm, not the consumer, but the **destination is the main economic agent**: the territory enters both the production and the utility function.

what is the tourism destination?

- the core of tourism system, where tourism structures, events and services are located and where tourists' needs are satisfied
- usually, the destination is geographically well defined, but its boundaries may often blur and evolve.

"a destination is a single district, town or city, or a clearly defined and contained rural, coastal or mountain area".

(Davidson and Maitland 1997, p.4)

- non-operational definition (too vague)

what is the tourism destination? (2)

a more precise definition defines a tourism destination as…

"*A geographical area of variable territorial scale, where tourism is a predominant activity both from a demand-side (i.e. tourists) and a supply-side (i.e. infrastructure and employment) perspective*" (Papatheodorou 2006, p. xv).

- limitations of this definition:
  1. it lacks any reference with the systemic nature of tourism;
  2. tourism is not necessarily a predominant economic activity in the destination.

what is the tourism destination? (3)

"the destination is a territorial system supplying at least one tourism product able to satisfy the complex needs of tourism demand" (Candela & Figini, 2012, chp. 3)

"it is indeed in the destination that tourism supply meets tourism demand; it is in the destination that environmental and cultural resources, attractions, the hospitality industry etc. are located; it is in the destination that tourism demand reveals itself. Therefore, the destination is the *trait d'union* between the **complexity** of the sector, the **complementarity** of the many goods and services which constitute the tourism product, and the **intangibility** stemming from the supply of the territory". (Candela & Figini, 2012, p. 257).

the definition is different w.r.t management studies (a product) and geography (the set of resources).

the economics of destinations (2)

the economics of destinations studies the relationship between **DEMAND** (by the different types of tourism hosted in the destination) and **SUPPLY** (by the mix of firms located in the territory) for the whole tourism product.

the destination is seen as an economic agent, with a **function to maximise** and subject to **given constraints**.

MACROECONOMICS
(the economic system)

ECONOMICS of DESTINATIONS
(the local territorial system)

MICROECONOMICS
(firms, households)

basics on tourism demand

the **tourism product** is a basket of different goods and services offered at the destination: it is a complex aggregate of heterogeneous products and plurality of tourism types → impossible to refer to a generic demand for tourism.

in tourism economics, the concept of demand can be referred only to segments of the market with significant degree of homogeneity → it is important to identify segments (e.g. business tourism)

two approaches to identify segments:

- a *territorial criterion* → tourism demand is defined in terms of a given destination, a given region, a given country, etc.
- a typology criterion → tourism demand is defined in terms of tourists' motivations, preferences, activities etc.

basics on tourism demand (2)

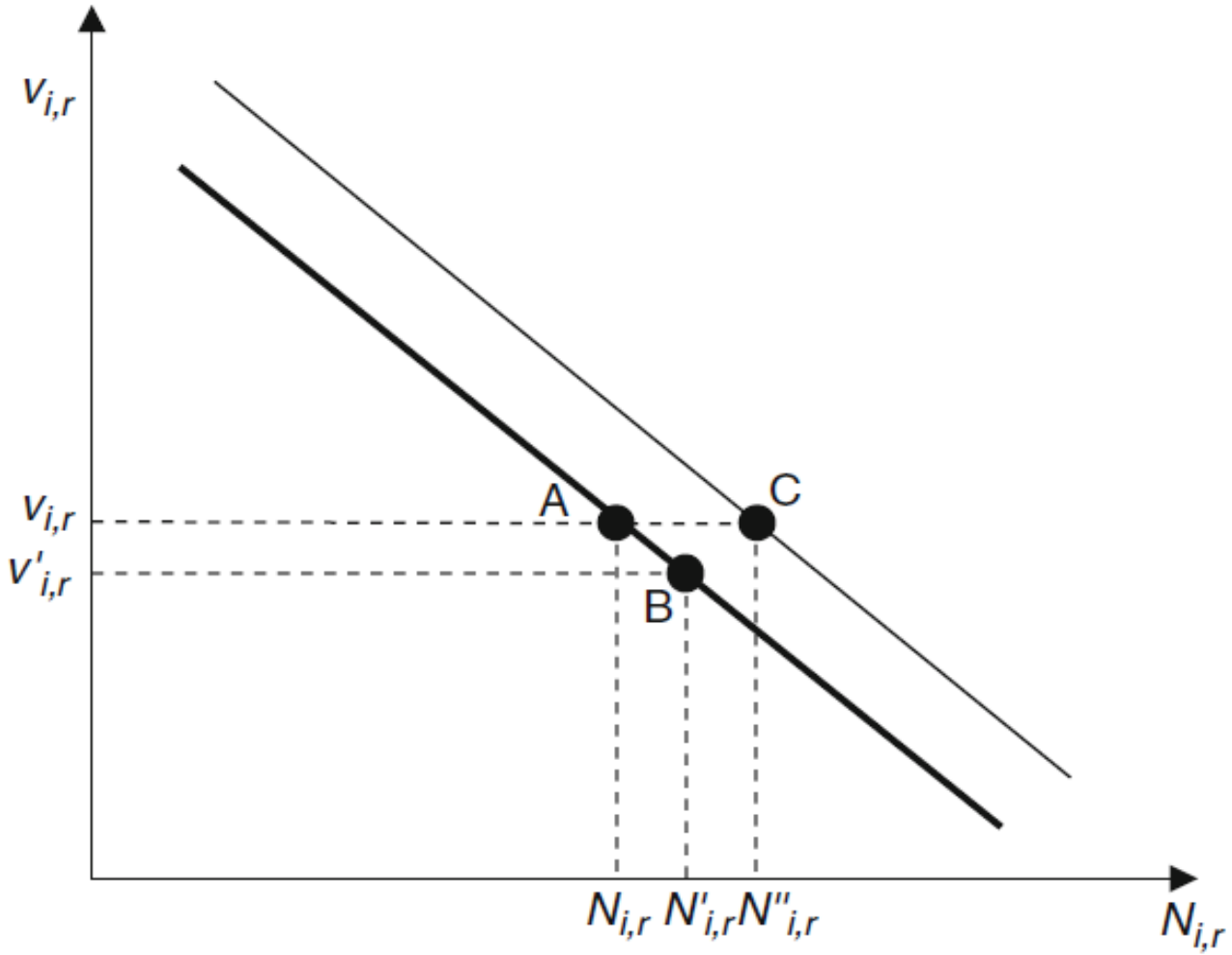
let's consider the territorial dimension: tourism demand in a destination

demand function: the relationship between the quantity of a good and its determinants.

$$N = f(v, v_j, R, \ldots)$$

where *N* represents the quantity of tourism products (nights spent in the destination) as a function of its unit (daily) price *v*, the price of alternative destinations, tourist's income and other qualitative variables such as: preferences, effects of fashion and advertisement, the behavior of other consumers, etc.)

comparative statics on the demand function



example 1

- alpha is a destination specialized in beach tourism. Recently, Alpha has experienced a contraction in tourists' overnight stays, $\downarrow N_{Alpha}$. what are the possible reasons?
  1. increase in the price of tourism at the destination, $\uparrow v_{Alpha}$, (e.g. variation in the exchange rate) → possible loss of competitiveness of Alpha → (movement along the curve).
  2. loss of interest for beach tourism in general $M_{beach}\downarrow$→ (movement of the curve).
  3. reduction of tourists' disposable income for tourism $M_{tou}\downarrow$→ *market effect* (movement of the curve).
  4. loss of Alpha's competitiveness for other reasons (e.g. obsolescence of tourism structures/infrastructures, environmental damage → (movement of the curve)

example 2

- beta is a destination specialized in mountain tourism. Recently, Beta has registered an increase in tourists' overnight stays, $\uparrow N_{Beta}$ Possible reasons:
  1. Competitive advantage of beta ($\downarrow v_{Beta}$, movement along the curve)
  2. idiosyncratic effect of winter tourism (e.g., increase in appeal for skiing; movement of the curve)
  3. increase in the price of competing destination gamma (movement of the curve).
- importance to distinguish the different reasons behind an expansion/contraction of the tourism demand → effectiveness of tourism planning and policy.

the elasticity of demand

it represents the percentage change of one variable stemming from a 1% change of another variable

own-price (direct) elasticity $\varepsilon = \left| (\partial N / \partial v)(v / N) \right|$

- $\varepsilon > 1$: elastic demand; $\varepsilon < 1$: inelastic demand; $\varepsilon = 1$: unit-elastic demand.

cross-price (indirect) elasticity

$$\mu_{(ij)r} = (\partial N_{ir} / \partial v_{jr})\ (v_{jr} / N_{ir})$$

$$\mu_{i(rk)} = (\partial N_{ir} / \partial v_{ik})\ (v_{ik} / N_{ir})$$

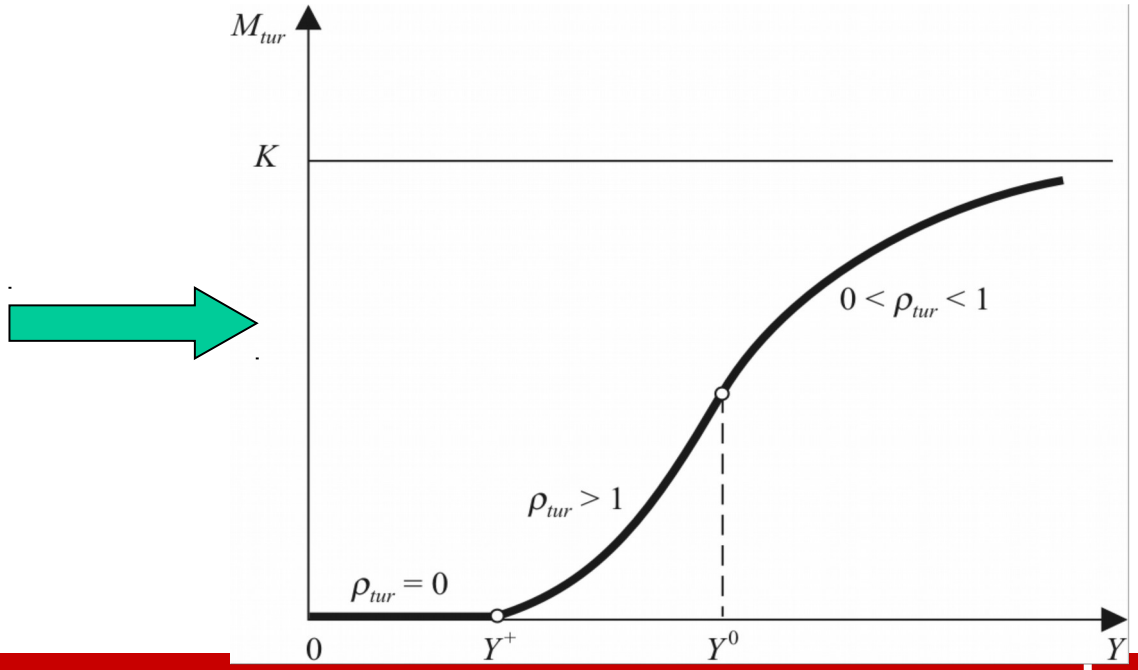
- $\mu_{(ij)r} > 0$ $(\mu_{i(rk)} > 0)$: substitute tourism; $\mu_{(ij)r} < 0$ $(\mu_{i(rk)} < 0)$: complementary tourism; $\mu_{(ij)r} = 0$ $(\mu_{i(rk)} = 0)$: independent tourism.

the elasticity of demand (2)

income elasticity of demand: $\rho = (\partial M / \partial Y)\ (Y / M)$

- $\rho < 0$: inferior tourism; $0 < \rho < 1$: normal tourism $\rho > 1$: luxury tourism

standard relationship between tourism expenditure and income:



the pricing policy for the destination

the goal of profit maximization is not attainable for the destination as *a whole* (the costs of the private sector are unknown):

real-world target: maximization of gross tourism receipts (expenditure of incoming tourists $S = vN$)

any change of v has a double effect on S: direct, and through the indirect effect on N.

the effect depends on the elasticity of demand:

three cases:

- tourists only decide on the basis of price;
- tourists decide also on the basis of quality;
- tourists decide in two steps: a) whether to travel; b) how long to stay.

the pricing policy for the destination (2)

A. price, overnight stays, and tourism receipts

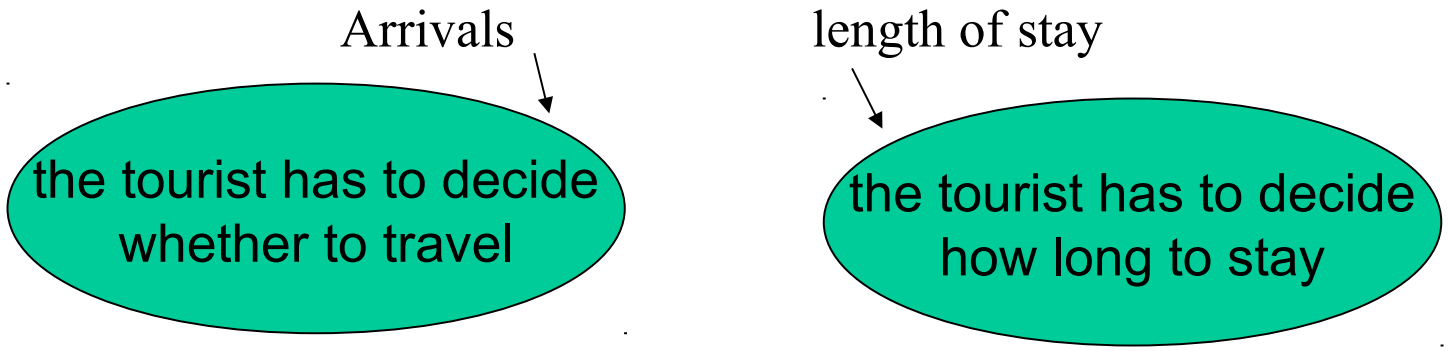
- identification of the price-nights spent combination in order to maximise tourists receipts: **Cournot equilibrium: $\varepsilon = 1$**
- destinations have to *blow with the wind*: if demand ↑, the destination has to ↑ the price

B. price, overnight stays and tourism quality

- quality inversely depends on the crowding: $\alpha(N_{ir})$, however it is always optimal to stay in the Cournot equilibrium.
- if the destination is crowded, the resource would be over-exploited, and in the optimal equilibrium the higher price associated to better quality more than compensates the reduction in overnight stays.

the pricing policy for the destination (3)

C. two-tier tourism demand : $N = AD$



the length of stay depends on price (standard consumption model)

$$D = D(v), \quad \text{con } D' < 0$$

the choice whether to travel depends on many socio-economical variables

$A = A(.)$

state of the infrastructure

state of the environment

tourism organization

congestion and crowding

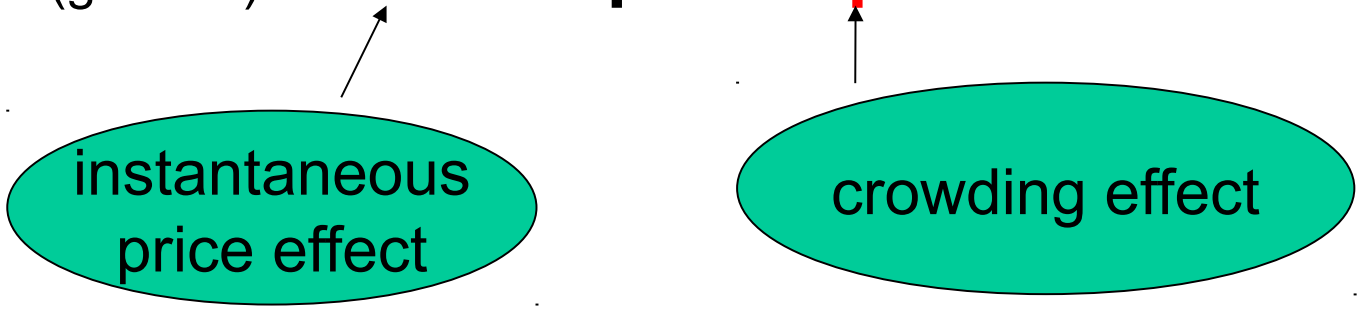
the pricing policy for the destination (4)

two alternative assumptions on the link arrivals - crowding

C.1 – tourists are driven by a snob effect: $N = A(N)\, D(v)$

$A = A(N)$ with $A' < 0$

if ↑ v (given A) ➔ ↓N ➔ ↑A ➔ ↑N



the overall effect, when tourists are driven by a snob effect, is to make the demand curve less elastic.

- it is possible to have a positively sloped demand curve

the pricing policy for the destination (5)

C.2 – tourists are driven by a bandwagon effect:

$$A = A(N) \quad \text{con} \quad A' > 0$$

if ↑ v (given A) → ↓N → ↓ A → ↓N

the overall effect, when tourists "love the crowd", is to make the demand curve more elastic.

a destination demanded by snob tourism should keep prices high;

a destination demanded by mass tourism should keep prices low.

it is not the price that makes a destination snob: it is the opposite

references for Lectures 04 and 05

Candela, G., & Figini, P. (2012). *The Economics of Tourism Destinations*, Berlin: Springer-Verlag, (chp. 4.1, 4.2, 4.4).